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Supreme Court of the United States.

OCTOBER TERM, 1948.

No.

LEE M. FRIEDMAN,
Petitioner,
v.
DENIS W. DELANEY, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MASSACHUSETTS,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Lee M. Friedman, respectfully presents to this Court this, his petition for a writ of certiorari, addressed to the United States Court of Appeals for the First Circuit, commanding such Court and the clerk thereof to certify to this Court the record and proceedings of this case in said Court in which case your petitioner was appellant and the respondent Collector was appellee, together with the opinions therein of said Court of Appeals, for review and determination of said cause by this Court.

This was an action originally brought to recover from the Collector of Internal Revenue for the District of Massa-

chusetts two separate items of taxes paid, alleging overpayment of personal income taxes for the year 1941 paid in 1942. The first item was not in dispute and is not involved in this petition, as judgment was rendered for the appellant for the same. The second item was decided by said Court of Appeals adversely to the appellant in two opinions concurring in the judgment but otherwise inconsistent.

Statement of the Case.

The facts were not in dispute. Chief Judge Magruder (R. 84-88) in his opinion repeated practically the summation of the salient facts as we ourselves set them forth in our brief as follows:

> Appellant is the senior member of the legal firm of Friedman, Atherton, King & Turner of Boston, Massachusetts. For many years he and his firm acted as attorneys in such legal matters as arose for Louis H. Wax, who was engaged in the wholesale and retail hardware business in Boston. Mr. Wax became involved in financial difficulties and in the early part of 1937 he was wiped out by a foreclosure, and many of his creditors were pressing him very hard for payment of overdue accounts. Wax owed $70,000. By letter dated March 12, 1937 (Ex. 3, R. 45), he advised his creditors that he could raise enough money to pay them 10% of their claims, in full settlement, if such a settlement could be made.
>
> Appellant, acting as attorney for Wax, assured the attorneys representing Wax's creditors that he would guarantee payment of the 10%, if acceptable. Wax had advised appellant that the necessary funds could be obtained from friends and by borrowing on a life in-

surance policy payable to his wife, which by statute was exempt from being available to creditors. The appellant made the commitment relying on Wax's assurances. On April 6, 1937, an involuntary petition in bankruptcy was filed against Wax by some small creditors. An offer of composition to carry out this settlement was then proposed by Wax in the bankruptcy proceedings, to pay the creditors the agreed 10%. By letters dated April 28, 1937 (Ex. 4, R. 46), and July 19, 1937 (Ex. 5, R. 47), appellant's firm requested the creditors to accept the composition offer and to file proofs of their claims. Appellant repeated his assurance to the creditors' attorneys that, although this was a "no assets" case, the 10% dividend would be forthcoming if accepted.

Mr. Wax refused to produce the $5000 which he had agreed he would contribute to the composition and repudiated his commitment to appellant. To make good the personal assurance which appellant had given to his fellow attorneys who had induced their clients to accept the debtor's offer of settlement (R. 28), on February 17, 1938, appellant, in compliance with the court's order (R. 27 and 29), deposited to the credit of the Clerk of the District Court $7000 in the bankruptcy case. $5000 of this was his own money. At the same time he filed a caveat with the court stating that no part of the deposit was paid or contributed by Wax. Certain lawyers representing a small minority of creditors, indulging in what appellant has characterized as pettifoggery, sought to oppose the composition, caused delays and prolonged the proceedings. The Referee took the position that appellant was under no obligation to continue a contest to have the composition confirmed and in the face of such conduct was entitled to abandon the settlement (R. 30-31). The

composition was then abandoned. On November 1, 1939, appellant filed a petition in which it was alleged that the proposed composition had been abandoned, that $5002.91 of the money which had been deposited was his own, and asked that the Receiver be ordered to return it to the appellant. After a contest extending over a period of two years of hearings and proceedings, as a matter of business judgment, when it appeared that there was a possibility of settling all contested matters and bringing the case to a final conclusion, on November 14, 1941, appellant filed an "agreement as to entry of decree" which referred to a petition filed by the Trustee in Bankruptcy for leave to compromise various controversies in the bankruptcy matter under which the appellant's $5002.91 was made a part of the bankrupt estate. The agreement recited that the sum was appellant's own money but that in connection with carrying out the compromise of all controversies in accordance with the Trustee's petition, and upon condition of the entry of a decree of the court authorizing the petition, appellant would not further oppose the entry of a decree directing that the $5002.91 be transferred to the Trustee of the bankrupt. In accordance with this agreement, appellant's "petition for return of deposit" was denied on November 14, 1941.

In his 1941 income tax return appellant claimed a deduction of $5000 by reason of the Wax bankruptcy transaction. The deduction was disallowed by the Commissioner, resulting in the assessment of the deficiency tax and interest, which was paid and recovery of which is now sought.

The claim for refund with respect to the item in issue was made in general terms. It states: ". . . the Commissioner erroneously refused to allow as a de-

duction, the sum of $5,000 lost by the taxpayer in the course of his connection with the Bankruptcy Proceedings of one Louis H. Wax . . ."

The appellant claimed that the payment was made to fulfill an undertaking to which he had personally committed himself. It was not a loan to Wax. He does not ask for a deduction for a bad debt. It was not a gift to Wax. It was not made to discharge any obligation or promise of Wax. It was paid into court as an incident of the appellant's practice of law, that when he gave his word it was good. It was a discharge of the taxpayer's own personal obligation—to live up to representations and promises he personally had made. He took upon himself all responsibility for making good a professional promise. At the time of the payment he believed Wax was honest and in one way or another would eventually make good on his word, as he had done in the past. It was on his confidence in Wax that appellant had made his personal commitment, expecting that eventually Wax would so handle the matter that the appellant would not eventually suffer a loss. Wax did not do this. The deduction is asked for as an expense or a loss incurred in the course of business, either under §23(a)(1), or §23(e)(1). The appellant's relations with Wax were wholly professional. There was no connection between them except that of attorney and client.

The Decision.

Points at Issue.

The Court of Appeals divided on the legal principles involved.

The case involves the interpretation and application of the provisions of I.R.C. §23(a)(1) and §23(e)(1). The opinion of the Court (Peters, D.J., R. 80-84) in effect held that the taxpayer had not brought himself within the provision allowing a deduction for a loss because the loss sustained was due to his "voluntary" act. The opinion of Chief Judge Magruder (R. 84-89) finds that the taxpayer would have been entitled to the deduction but lost the right to it because he did not take appeals from the Referee's adverse decision which the judge believed erroneous and suggests would have been reversed by some higher tribunal and the loss avoided.

The reasons relied on by your petitioner for issuance of said writ, and upon which your petitioner believes the writ ought to be issued, are as follows:

1. The case presents issues involving interpretation and application of provisions of the tax statutes, the correct interpretation of which is important both to the Government and to the taxpayers.
2. §23(e)(1) has never been authoritatively adjudicated by this Court or by any Court of appellate jurisdiction except in this instance.
3. The Court of Appeals' interpretation of §23(e)(1) in this litigation is clearly erroneous in that, in spite of a difference in the wording of the two sections, the decision in effect holds §23(e)(1) merely repetitious of §23(a)(1).
4. The decision is in conflict with decisions of the Courts of Appeal in other circuits under §23(a)(1) and the decision of this Court on matters herein involved is necessary so that the interpretation of the tax statute may be kept uniform throughout the various circuits.
5. The opinion of the Chief Judge introduces a new and dangerous element as a test in tax cases. It

holds that a taxpayer is not entitled to deduct a loss taken under a Court's decision if the Tax Court later thinks that decision was erroneous and could have been set aside on appeal. It errs in failing to realize that a right of appeal confers upon the litigant a privilege and does not impose a duty of appealing.

Wherefore your petitioner prays that a writ of certiorari herein issue.

LEE M. FRIEDMAN.

COMMONWEALTH OF MASSACHUSETTS.

SUFFOLK, ss. BOSTON, January 20, 1949.

Lee M. Friedman, first being duly sworn, deposes and says that he is the petitioner and a member of the Bar of this Honorable Court; that he has read the foregoing annexed petition, and knows well the contents thereof; that he also carefully had read and studied the transcript of the record which accompanies said petition, being the transcript of the record of the case at bar; that the matters in said petition contained are, in the judgment of the affiant, duly supported in and by said transcript of record and the certificate of the clerk of the District Court of the United States for the District of Massachusetts, submitted with said petition; and that he knows of the above proceedings had, and that the acts and facts in said petition stated are true to the best of his knowledge and belief.

Subscribed and sworn to before me the day and year first above written.

SIDNEY WERLIN,
Notary Public.

We do hereby each certify that we each carefully have examined the foregoing petition for a writ of certiorari; that the allegations thereof are true, as we each verily believe, and in the opinion of each of us the petition is well founded and the case is one in which the prayers of the petition should be granted by this Court.

LEE M. FRIEDMAN,
LOUIS B. KING,
Counsel for Petitioner.

Supreme Court of the United States.

OCTOBER TERM, 1948.

No.

LEE M. FRIEDMAN,
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DENIS W. DELANEY, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MASSACHUSETTS,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The Issues Involved.

The petition has set forth the facts which were undisputed.

§23(a)(1) (as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, sec. 121), Deductions from Gross Income (26 U.S.C. 1946 at § 23), provides:

> "(a) *Expenses.*—(1) *Trade or business expenses.*
>
> "(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pur-

suit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

§23(e)(1) provides:

"(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

"(1) if incurred in trade or business; or . . ."

Argument.

I.

DIFFERENCE BETWEEN §23(a)(1) AND §23(e)(1).

§23(e)(1) has not been passed upon by this or any other Court of appellate jurisdiction for construction.

If, as generally said, §23(e)(1) is broader than §23(a)(1), then the appellant is entitled to the claimed deduction.

The Court treated §23(e)(1) as if it were mere repetition of §23(a)(1) and in no way enlarged the range of allowable deductions for an individual as specified in §23(a)(1).

The language of §23(e)(1) applies only to individuals, but, without qualifying words, it allows *all* losses suffered if incurred by an individual in trade or business. Such losses need not be the "ordinary and necessary expenses" of §23(a)(1). The only limitation imposed upon the individual allowable deductions is that they should be losses incurred in trade or business.

The term "trade or business" means any pursuit or occupation to which the appellant devotes his time and attention for the purpose of a livelihood. It necessarily includes the practice of law. This Court has said: " 'Business' is a very comprehensive term and embraces everything about which a person can be employed," and cites with approval the definition of business from Bouvier's Law Dictionary: "That which occupies the time, attention and labor of men for the purpose of a livelihood or profit."

Flint v. *Stone Tracy Co.*, 220 U.S. 107, 171.

This has been approved in later decisions.

See *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503, 514-515.

See also 12 C.J.S., "Business," pp. 761, 762, 766.

The test seems to be whether the taxpayer's activities are carried on to secure a profit. Thus a farmer who conducts his farm as a business is entitled to deduct losses while one who runs his farm as a hobby is not so entitled.

II.

"ORDINARY AND NECESSARY EXPENSES" UNDER §23(a)(1) INCURRED IN A TRADE OR BUSINESS.

The interpretation under this section of what are "ordinary and necessary expenses" incurred in a trade or business adopted by the decision of the Court of Appeals for the First Circuit is in direct conflict with decisions of other Courts of Appeals of long standing.

Dunn & McCarthy v. *Commissioner*, 139 F. (2d) 242 (C.C.A. 2).

A. Harris & Co. v. *Lucas*, 48 F. (2d) 187 (C.C.A. 5).

Helvering v. *Community Bond & Mortgage Corporation*, 74 F. (2d) 727 (C.C.A. 2).

McGee v. *Nee*, 113 F. (2d) 543 (C.C.A. 8).

See also

Miller v. *Commissioner*, 37 B.T.A. 830.

Scruggs, Vandervoorst-Barney Inc. v. *Commissioner*, 7 T.C. 779.

First National Bank of Skowhegan v. *Commissioner*, 35 B.T.A. 876, 884-886.

Camp Manufacturing Co. v. *Commissioner*, 3 T.C. 467, 472.

Catholic News Publishing Co. v. *Commissioner*, 10 T.C. 73.

Chief Judge Magruder pointed this out in his opinion (R. 86) and thinks his Court should have followed the Dunn & McCarthy and A. Harris decisions.

The instant decision introduces a new, undesirable and unwarranted test and element into what are "ordinary and necessary expenses" in business under the Internal Revenue law—namely, whether such expenses are the result of "voluntary" or "involuntary" action on the part of the taxpayer; that is, whether in the judgment of the tax authorities the loss on the part of the taxpayer was brought about by some voluntary act or non-action which he did, or refrained from doing on his own.

In a sense, in business everything which a businessman does is voluntary. There is no law or compulsion which makes him buy cotton or wool for his mill when had he

not bought he would not have suffered a loss when the market broke and prices fell. When a man drove his truck to deliver merchandise and smashed it when he was under no compulsion to make deliveries but might have waited until the buyer called for delivery, he "voluntarily" did something in his business which caused the loss.

When a businessman at the expense of his business provides recreation, vacation camps or extra attentions for his workmen which no law requires, it is all "voluntary" and is a loss or expense in his business which he could have avoided by refraining from doing what he was under no legal obligation to do.

The present decision advances the novel and unsound proposition that a business loss which is not made in consequence of a legally enforceable obligation is a "voluntary" transaction by the taxpayer and therefore not a deductible loss. It advances the theory that, if a loss in a business was due to living up to a moral obligation which the taxpayer might have avoided by breaking his word, or escaped through the use of technicalities, such as pleading the Statute of Frauds, to which he did not resort, under tax law there is no deductible loss.

Is not the test whether the taxpayer incurred the loss or expense in good faith according to his judgment of the proper way to conduct his business rather than the opinion of tax authorities or a Court as to whether the taxpayer was discharging a legal obligation or doing something he could have sidestepped and thereby saved money? Is the right of a taxpayer to a deduction for a business loss to depend on what the Government determines afterwards could have been avoided had the taxpayer not done what he had chosen to do?

III.

UNDER §23(e)(1) THE LIMITATIONS OF §23(a)(1) OF "ORDINARY AND NECESSARY" ARE ELIMINATED.

Under 23(e)(1), if there is an actual loss in the business conducted by an individual incurred in good faith, there is a deductible loss and that is all there is to it.

Its deductibility does not depend on whether Government agents later decide—

(a) That the loss could have been avoided;
(b) It was not necessary;
(c) It was not usual;
(d) It was the result of bad judgment;
(e) The loss was not the result of legal liability which he could have resisted.

IV.

JUDGE MAGRUDER'S OPINION* INTRODUCES INTO TAX DEDUCTIONS AN ERRONEOUS ELEMENT.

A most dangerous principle in federal taxation is enunciated in his opinion as the basis of Judge Magruder's

*Judge Magruder (R. 89) says: "The record contains no basis for a finding that it was part of Friedman's business as a practicing lawyer to contribute $5000 of his own money to the bankrupt estate of his client Wax in order to induce the trustee in bankruptcy to accept a compromise settlement of the claim of the estate against the Malden Trust Company." He was in absolute error and misinterpreted the record. There is not the least suggestion in the record that Friedman made a contribution to induce the Trustee to accept a compromise of the claim against the Malden Trust Company. The record only shows that in a single petition the Trustee sought authority from the Referee in Bankruptcy to settle a series of claims and suits (R. 51-53). There is no suggestion that any one of them had any relation to another, nor any suggestion that any settlement had any relation to another, or

acquiescence in the decision. It rests on the idea that the taxpayer cannot accept the decision of a Court of first instance establishing his loss if the Tax Court or another United States Court later thinks that the decision was erroneous. His opinion puts it that the taxpayer should have appealed the decision imposing the loss and won his case in some appellate jurisdiction. The logic of that position is that until the taxpayer wins or loses in the very highest Court of last resort the status of his loss is questionable and continues to be such unless a Tax Court approves as correct the decision of a lower Court deciding against the taxpayer.

This ignores that at least as to the taxpayer the trial Court's decision is *res judicata* and there is no legal nor moral obligation to continue litigation until all appeals are exhausted.

It fails to recognize that in litigation a right of appeal confers a privilege and imposes no duty upon a litigant to exercise such rights.

V.

It is respectfully submitted that the writ herein prayed should issue to the end—

1. That an authoritative decision may be had eliminating the conflict between the decision of the Court of Ap-

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depended on any other. It was just sloppy pleading and a cheap way of saving time and work to bunch together different pending controversies in which the Trustee was engaged so as to save expense of separate notifications to creditors [Bankruptcy Act §58a(6)] in asking authority from the Court to permit the settlements of independent and unrelated suits and claims. There was no basis for assuming that Friedman was interested in anything other than his $5000. Judge Magruder might just as well have assumed that Friedman was paying the $4000 mentioned as being received in compromise of some of the claims being settled. His remarks were gratuitous, without foundation, and wholly wrong.

peals for the First Circuit and those of other circuits as to the proper interpretation of §23(a)(1) of the Internal Revenue Code.

2. That a proper interpretation of §23(e)(1) may be had to avoid future miscarriages of justice under the precedent of the decision hereby challenged.

Respectfully submitted,

FRIEDMAN, ATHERTON, KING
& TURNER,
LEE M. FRIEDMAN,
LOUIS B. KING,
Counsel for the Petitioner.